

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201045006**

Release Date: 11/12/2010

Index Number: 1362.04-00

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-108435-10

Date:

July 14, 2010

Legend

X =

Y =

a =

b =

c =

d =

e =

f =

g =

L =

M =

N =

Q =

P =

State =

Date1 =

Date2 =

Date3 =

Year1 =

Year2 =

Dear _____ :

This responds to a letter dated February 19, 2010, submitted on behalf of X by X's authorized representative, requesting a ruling that the rental income received by X from certain rental real estate is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code (the Code).

The information submitted states that X was incorporated under the laws of State on Date1. Y is a wholly-owned subsidiary of X that was incorporated under the laws of State on Date2. X elected to be an S corporation effective Date3, and X also made the election under § 1362(b)(3)(B) to treat Y as a qualified subchapter S subsidiary effective Date3. X, through Y, develops, owns, operates and leases high-technology office buildings, and provides high-technology companies with facilities, security, office management, and onsite technologies. Y currently owns a office buildings, and operates and leases a total of b office buildings (including buildings leased from third parties): L, M, N, O, and P (collectively, the "Properties"). Y also owns undeveloped land contiguous to the Properties, and this undeveloped land gives Y the potential to significantly increase the amount of high-technology office space it can develop, own, operate and lease in the future.

Y's tenants primarily include small high-technology companies that are in the initial stages of their development and growth. Y provides its tenants with office space with potential to expand as the tenants grow in size. Y also provides its tenants with expertise and assistance in the areas of space planning, leasing, and facility management. Y currently has c tenants that occupy the Properties.

Y utilizes a standard form lease with a base year for all of its tenants. Under the form lease, Y is generally responsible for the payment of taxes, maintenance, insurance, and utilities. The tenants pay a certain base rent and a share of the operating expenses for the calendar year in which the tenancy begins. Thereafter, the tenants are responsible for their proportionate share of any increase in the operating expenses over the base year expenses. X and Y operate, manage, and maintain the Properties through a full-time employee, certain other individuals, and a property management company. The services provided for the Properties include (1) the maintenance of all mechanical, electrical, BMS and control monitoring, emergency power, fire alarm, elevators, plumbing, and other major and minor systems in the Properties; (2) the performance of exterior and interior cleaning, painting, decorating, plumbing, carpentry, landscaping, roofing, maintenance of heating, ventilating and air conditioning systems, and such other normal maintenance, repair work and minor construction as may be necessary; (3) investigating all necessary preventative maintenance programs; (4) purchasing supplies, materials and services; and (5) regularly inspecting and testing the physical condition of the Properties. X and Y also provide various services to the tenants including janitorial services, security services, rubbish removal, interior and exterior landscape maintenance, vermin extermination, and other services that may be required for the proper operation of the Properties.

In Year1, X collected approximately \$d in gross rents and incurred approximately \$e in relevant operating expenses for the Properties. In Year2, X collected approximately \$f in gross rents and incurred approximately \$g in relevant operating expenses for the Properties. X also represents that X and Y both have accumulated earnings and profits.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(iii)B)(i) of the Income Tax Regulations provides that “rents” means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that “rents” does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in the active trade or business of renting property only if, based on all of the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all of the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts submitted and the representations made, we conclude that the rental income X receives from its operations described above is not passive investment income under § 1362(d)(3)(C)(i).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b). Further, the passive investment income rules of § 1362 are independent of the passive activity loss rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, copies of this letter are being sent to X's authorized representatives.

Sincerely,

Bradford R. Poston
Acting Chief, Branch 2
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes